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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of	)	
the Cable Television Consumer	)	MM Docket 92-266
Protection and Competition Act	)	
of 1992	)	
	)	
Rate Regulation	)	

PETITION FOR RECONSIDERATION

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PETITION FOR RECONSIDERATION

Cablevision Systems Corporation ("Cablevision"), by its attorneys, hereby petitions the Commission to reconsider its Report and Order and Further Notice of Proposed Rulemaking, released May 3, 1993, in the above-captioned proceeding ("Report and Order").

INTRODUCTION AND SUMMARY

In several significant respects, the regulations imposed on cable operators and programmers by the Commission's Report and Order are neither compelled by statute nor justified on public policy grounds. They will unnecessarily burden the offering of cable programming services, and threaten to inhibit the cable industry's continued investment in advanced facilities and diverse programming.

With respect to the regulation of equipment, the Commission's overbroad definition of "basic" equipment and its decision to impose the "actual cost" standard on essentially all equipment used to receive cable programming will have the perverse effect of inhibiting innovation and subscriber choice. By severely limiting the incentives of cable operators and equipment manufacturers to add functionality and value to the equipment interface between subscribers and cable networks, the Commission's rules could unnecessarily impede nascent efforts to unlock the full potential of those networks to serve as a multi-purpose telecommunications infrastructure. Just as the digitization of electronic information is leading to the convergence of the cable, telephone, and computer industries, the deadweight of regulation applicable solely to equipment furnished by the cable industry will hobble cable's efforts to become a provider of interactive networks accessed through increasingly sophisticated subscriber terminal devices.

The Commission can and should narrow the scope of equipment subject to regulation on an actual cost basis to that equipment made available to basic-only subscribers. Operators should be able to bundle the offering of other tiers of service and associated equipment at whatever price they choose, so long as the package is "not unreasonable" under the factors articulated in the statute. Consistent with the discretionary nature of cable programming services (including associated equipment), there is no public policy or statutory rationale for regulating the rates for such equipment and services if those rates are within the mainstream of rates charged by all operators. Converters that incorporate the functionalities of customer premises equipment should be totally exempt from rate regulation.

The formula adopted by the Commission to determine the maximum reasonable rates for leased commercial access could likewise stifle investment in cable facilities by depriving operators of a reasonable return on leased access capacity. The "implicit fee" prescribed in the Report and Order is based on full-time use of a channel by non-leased access programmers, which guarantees the operator a fixed revenue stream. Simply pro-rating this fee to determine rates for leased access part-time use, which will render a channel unavailable for full-time use, is unlikely to permit the operator to recover the costs of providing the channel. The artificially low rate that results from prorating the implicit fee for full-time use will, contrary to the statutory directive, adversely affect the financial condition of cable systems and, thus, the quality of cable service.

The Commission's limitation on the pass-through of programming costs attributable to affiliated providers will stifle diversity by depriving vertically integrated programmers of the ability to recover their full costs of producing and developing programming. The pass-through limitation will also place such programmers at a competitive disadvantage with respect to non-integrated programmers, further diminishing diversity and subscriber choice.

The pass-through limitation should be removed. There is nothing in the record of this proceeding suggesting that vertically integrated programmers are more likely than any other programmers to overcharge operators. In addition, the limitation was promulgated without adequate notice and opportunity to comment, and suffers serious constitutional infirmities. Whatever theoretical benefits might accrue to the affiliated operator by cost shifting are significantly attenuated where, as in the case of Cablevision's affiliated Rainbow programming services, half or more of the ownership in the programming services is shared with third parties. In the case of non-integrated programmers, the Commission has correctly determined that the risk of collusion between operators and programmers is *de minimis* and worth taking in order to foster programming diversity. The same conclusion applies to programming services affiliated with cable operators.

Finally, the Commission should reconsider its decision to limit future rate increases to the price cap formula articulated in the Report and Order. Under this approach, cable operators will have little or no incentive to add new channels or to continue to invest billions of dollars in advanced facilities unless they choose to undertake a burdensome cost-of-service showing. The inflation-based price cap approach was developed for an industry -- telephony -- with a far different financial structure than the cable industry. For cable operators, in the midst of rebuilding systems and with their substantial cash flow requirements, price caps is an ill-fitting Procrustean bed. Forcing them within its confines will disserve the public interest by impeding the growth and development of cable, and will unfairly tilt the playing field in favor of the telephone companies for which the price cap approach was originally designed.

I. ONLY EQUIPMENT PROVIDED TO BASIC SUBSCRIBERS SHOULD BE SUBJECT TO THE ACTUAL COST STANDARD

The 1992 Cable Act[1/] requires the Commission to adopt standards to establish, on the basis of "actual cost," the rates charged for "installation and lease of the equipment used by subscribers to receive the basic service tier."[2/] The Commission has interpreted this provision to apply broadly to *all* equipment used to receive the basic service tier, even if it is also used to receive other cable services.[3/] Under this interpretation, virtually all equipment

[1/] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992) ("1992 Cable Act").

[2/] 47 U.S.C. § 543(b)(3(A).

[3/] Report and Order at ¶ 273.

will be regulated as "basic."[4] In addition, the Commission has decided to subject "cable programming service" equipment, if any, to the actual cost standard.[5] As a result, the rates for *all* equipment used to receive tiers of service (and even equipment used to receive per channel or per program services, if such equipment is also "used" to receive the basic service tier) will be governed by the actual cost standard.

The Commission's decision to sweep all equipment under the actual cost standard will stifle the development of innovative subscriber equipment and is unnecessary to comply with the statutory requirement that equipment other than basic equipment be priced at a level that is not "unreasonable." On reconsideration, the Commission should limit the applicability of its actual cost standard to the equipment (including a converter, if any, and an associated remote control unit) made available to a basic service customer. Consistent with the discretionary nature of "cable programming services," equipment provided to customers of such services should be subject to a less stringent regulatory standard that seeks only to protect consumers against excessive rates for a package of equipment and services. Converters that add incremental features unrelated to the receipt of cable services, such as digital audio or facsimile capability, should be totally exempt from rate regulation.

A. SUBJECTING ALL EQUIPMENT TO THE "ACTUAL COST" STANDARD WILL STIFLE INNOVATION

Unless the Commission substantially narrows the scope of equipment subject to the "actual cost" standard, the promise of a multi-purpose, interactive cable infrastructure will be

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[4] See id., Appendix D, FCC Form 393 -- Part I, at p. 5.

[5] Id. at ¶ 407.

significantly delayed. Advances in set-top converters and other subscriber equipment are critical to enabling cable operators and their subscribers to realize the full potential of the investment that the cable industry has made and continues to make in a nationwide broadband network. According to recent reports, cable companies are already joining with computer companies and others to begin the innovative process of transforming cable converters into "smart" equipment with enhanced interactive capabilities.[6]

These efforts will be frustrated and future design and development plans inhibited if essentially all such equipment is subject to regulation by local governments under the restrictive "actual cost" standard. As cable, telephone, and computer technology begins to converge, the imposition of such a regulatory burden on cable alone is unwarranted and for instance, consumers will be able to obtain other telecommunications services with the same equipment that they use to obtain cable television. As competition in the advanced consumer electronics market grows, encouraged by a regulatory environment that permits pricing flexibility, interactive equipment will become more affordable and more consumers will be able to take advantage of it.

This pricing flexibility need not expose consumers to the risk of "excessive" equipment prices, moreover. Because the price for "cable programming services" (defined to include non-basic programming tiers as well as the equipment used to receive such tiers) remains subject to review by the Commission in response to complaints, consumers can be assured that such prices will not be "unreasonable." There is simply no justification or need to impose the straightjacket of "actual costs," intended by Congress only to ensure that a basic level of service remains affordable and accessible, on all equipment.

B. THE 1992 CABLE ACT LIMITS THE "ACTUAL COST" STANDARD TO EQUIPMENT MADE AVAILABLE TO BASIC-ONLY SUBSCRIBERS

In addition to contradicting sound public policy, the Commission's decision to apply the actual cost standard to all equipment is contrary to the law. The language and intent of the 1992 Cable Act make clear that the applicability of the actual cost standard is limited to equipment made available to basic-only subscribers. For all other equipment used in connection with service, the "not unreasonable" standard applicable to cable programming services should apply. Under this standard, operators should have the flexibility to bundle services and equipment together, with the rates for such packages subject to regulation only to the extent that they are outside the mainstream of rates charged by all operators. Such a standard is consistent with the discretionary nature of these services and the equipment used to receive them.

The Commission has misread and mischaracterized the legislative history of the 1992 Cable Act in support of its conclusion that "basic" equipment includes all equipment used to receive basic service, even if such equipment is also used to receive other cable services. Although the enacted statute applies the actual cost standard to equipment "used" to receive the basic service tier, rather than to equipment "necessary" to receive that tier, as the House bill provided,[7] the substitution of "used" for "necessary" was intended only to "give[] the FCC greater authority to protect the interests of the consumer."[8]

While the Commission acknowledges this rationale, it leaps inexplicably to the was mandating that the FCC sweep all rates for equipment under the actual cost standard is flatly inconsistent with and undermines the stated goal of granting the FCC greater flexibility and authority.

Moreover, the House-Senate conferees clarified the limited effect of the substitution of "used" for "necessary" on the scope of basic equipment regulation by concurrently amending the definition of "cable programming service" to include the installation or lease of equipment "used" for the receipt of such programming.[10] If Congress had intended for the Commission to interpret "used" expansively to regulate essentially all equipment as basic, it would not have then decided to specifically include equipment in the definition of "cable programming service." Such a change to "cable programming service" would have been virtually meaningless, despite the Commission's claim to the contrary.[11]

The Commission also erred in its decision to apply the "actual cost" standard to the installation or lease of equipment used to receive "cable programming service." Such a rule is not only not required by the statute, as the Commission itself recognizes,[12] but it is

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[10] See Conference Report at 66. The Commission's interpretation of the scope of basic service equipment forces two vastly different meanings on the word "used" within the same section of a statute. In the context of basic equipment, the Commission imports an extremely

contrary to congressional intent and the statutory language. Had Congress intended to regulate "cable programming service" equipment on the basis of actual cost, it would have explicitly said so, as it did for "basic" equipment.

"entry level" package of basic service and equipment. By contrast, "cable programming services" (including the equipment necessary to receive such services) are discretionary; there is no compelling need to subject such services or equipment to the same severe regulatory treatment that the statute prescribes for basic services and equipment. Regulation of cable programming services only to the extent necessary to "rein in the renegades of the cable industry"[17] -- excluding operators whose prices are within the mainstream -- gives proper effect to the difference in statutory language between "not unreasonable" and "reasonable" and satisfies the strong public interest in encouraging innovation in the design and development of advanced equipment.

Cable operators should also be permitted to bundle cable programming services and associated equipment, so long as the resulting package of equipment and services is "not unreasonable."[18] Bundling gives cable operators greater flexibility to introduce new and innovative equipment, the price of which, at least initially, might exceed "actual cost." Manufacturers will be less likely to invest in the production of advanced converters, and operators will be less willing to offer them, if they are not afforded such increased flexibility in pricing equipment.[19]

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[17] See 138 Cong. Rec. E1033 (Apr. 10, 1992) (statement of Rep. Markey).

[18] As the Commission itself recognizes, the statute does not require that the rates for equipment and installation be unbundled from the rates for cable programming services. See Report and Order at ¶ 410.

[19] Cablevision reiterates its request for the establishment of an equipment "basket" that would permit operators at their discretion to charge below-cost rates for certain basic equipment (*e.g.*, installations), so long as the rates charged for all basic equipment are no more than the total cost of such equipment. To the extent that non-basic equipment remains subject to the "actual cost" standard, such a "basket" approach should apply to all equipment covered by that standard.

Finally, the Commission erroneously failed to exempt from rate regulation converters that incorporate the functionalities of CPE (e.g., handsets for personal communications programmer of the same category to use non-leased access channels.[22] For less than full-time use, the Commission directs operators to pro-rate this implicit fee.[23]

The application of the Commission's formula to part-time leased access use will deprive operators of a reasonable return on leased access capacity. The "implicit fee" prescribed in the Report and Order is based on full-time use of a channel by non-leased access programmers, which guarantees the operator a fixed revenue stream. Simply pro-rating this fee to determine rates for part-time use, which will render a channel unavailable for full-time use, is unlikely to permit the operator to recover the costs of providing the channel. The artificially low rate that results from prorating the implicit fee for full-time use will, contrary to the statutory directive, adversely affect the financial condition of cable systems and, thus, the quality of cable service.[24]

For example, using the Commission's example of an implicit monthly fee $0.50 per subscriber paid by a public broadcasting station[25] and pro-rating it, the maximum rate that could be charged a leased access user in a system with 10,000 subscribers would be slightly

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[22] See Report and Order at ¶¶ 515-522.

[23] Id. at ¶ 518.

[24] A prorated leased access fee based on the implicit fee for full-time channel use is particularly inadequate in the case of multiple system operators ("MSOs"). While the Commission purports to take a system-specific approach to setting leased access rates, see id. at ¶ 519, its formula will not necessarily yield a system-specific rate for systems operated by MSOs. Most MSOs negotiate their programming service contracts at the MSO level, paying for programming at rates that do not reflect the individual characteristics of their systems. An implicit fee derived from a programming fee negotiated at the MSO level may be inadequate to ensure that leased channel use on a particular system does not "adversely affect the operation, financial condition or market development" of that system, as required under the Communications Act. See 47 U.S.C. § 532(c)(1).

[25] See Report and Order at ¶ 518 n.1312.

less than $7.00 an hour.[26] While this hourly rate might be sufficient to remunerate the operator in the case of a programmer that uses the channel on a full-time basis, it is entirely insufficient to cover part-time use. Once the operator has leased a small segment of time on a leased access channel, for instance, it loses the ability to lease the channel on a full-time basis. A price of $7.00 an hour, with no assurance that every hour on the channel will be leased, will not adequately compensate the operator for the channel capacity.

In addition to failing to reflect the true value of part-time use, the artificially low rate for leased access produced by the Commission's monthly implicit fee formula could undermine an operator's advertising revenues. Certain types of advertising, for instance, might fall within the "other" category, rather than the home shopping category. Again using the Commission's public broadcasting example, this advertising could be placed on leased access channels for one half hour for approximately $3.50. This rate is substantially less than the rate charged for advertising on other cable channels, contributing to a migration of such advertisers to leased access channels and a significant loss of operator advertising revenues.

Moreover, calculated under the Commission's formula, the monthly implicit fee paid by home shopping networks is not a true "maximum" rate. Many of the home shopping

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[26] Although the Commission does not explicitly say so, Cablevision assumes that the charge to a leased access user would be the implicit monthly fee per subscriber times the total number of subscribers served by a system, rather than the number of subscribers that actually purchase or view the service. Limiting the charge to the product of the per subscriber fee times the number of subscribers purchasing or viewing the service would yield an absurdly low rate that is in fact far less than the maximum monthly access rate paid by a non-leased access programmer. To avoid confusion, the Commission should clarify this point.

networks currently carried on cable systems pay operators a percentage of their sales revenues. Home shopping channels may seek to avoid paying such fees by leasing access channels on a part-time basis, taking advantage of the preferential pro-rated lease rates, thereby reducing the revenue cable operators earn from sales commissions.[27] The small, prorated fee received for leased access use will be insufficient to compensate operators for these lost commissions.[28]

The Commission correctly recognizes its statutory obligation to ensure that cable operators are permitted to charge a price for leased commercial access use that is "at least sufficient to assure that such use will not adversely affect the operation, financial condition or market development of the cable system."[29] By permitting cable operators to recover

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[27] A similar result would occur if, because of a proliferation of leased access home shopping shows, non-leased access home shopping networks suffer a decrease in consumer sales. Congress has recognized that the economic viability of a cable system could be harmed, contrary to statutory intent, by a decrease in cable operator revenues caused by audience migration that results from unfairly low prices for leased access use. See H.R. Rep. No. 934, 98th Cong., 2d Sess. 50 (1984) ("1984 House Report").

[28] It does not appear that the Commission would permit the sales commissions earned by cable operators from home shopping networks to be counted in determining the implicit monthly fee per subscriber, given the Commission's statement that the implicit fee "should recover the value of channel capacity only," and "should not include fees, stated or implied, for services other than provision of channel capacity (e.g., billing and collection, marketing, or studio services)." Report and Order at ¶ 518. Cablevision seeks clarification of this point.

The Commission's decision to include per event and per channel programming in the same category is also confusing. It is unclear, for instance, whether or not the Commission intends to permit operators to charge leased access users providing per channel programming akin to HBO a monthly rate based on the high implicit fee paid by programmers for per event programming. The fees paid for per channel and per event programming are not comparable. The Commission should also clarify this aspect of its Report and Order.

[29] 47 U.S.C. § 532(c)(1), (4)(A)(i); see 1984 House Report at 50. See also Report and Order at ¶ 515.

only nominal sums for what amounts to use of an entire channel, however, the Commission's implicit fee formula encourages adverse financial effects from the provision of leased access costs to the lesser of the annual incremental percentage increase in such costs or the GNP-PI.[31]

The limitation on the pass-through of affiliated programming costs is unnecessary and is contrary to sound public policy. There is nothing in the record of this proceeding suggesting that vertically integrated programmers are more likely than any other programming services,[34] half or more of the ownership in the programming services is shared with third parties. Ownership of Bravo, Rainbow's arts and cultural programming service, is evenly divided between Cablevision and the National Broadcasting Company, Inc. ("NBC"), which owns no cable systems. Cablevision owns only 25 percent of American Movie Classics. If Rainbow inflated the rates charged to Cablevision-owned systems for those services, Cablevision would capture only a fraction of the increased price. This partial benefit would not be sufficient to offset the loss of system subscribers that would likely result from excessive rate increases.

In the absence of any justifiable rationale for imposing limitations on the pass-through of programming costs attributable to affiliated programming services,[35] sound public policy and the legal restrictions placed on administrative agencies dictate that there be none.[36]

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[34] These programming services include Bravo Network, American Movie Classics, News 12 Long Island (a regional news service serving Long Island), eight regional SportsChannel services, the national backdrop sports services of Prime SportsChannel Networks, and Prism (a premium sports and movie service serving the Philadelphia market).

[35] There is no analogy here between the provision of programming to cable operators by affiliated programmers and the pre-divestiture provision of equipment to the Bell Operating Companies ("BOCs") by Western Electric. The vertically-integrated nature of the Bell System prior to divestiture involved such an extreme identity of ownership that it permitted Western Electric to unilaterally determine and dictate, for instance, the price paid by the BOCs for equipment. See American Telephone and Telegraph Co., 64 FCC 2d 1, 43 (1977). As noted, here, a cable system's cable operators will not necessarily accept inflated programming prices from an affiliated programmer. Vertically integrated MSOs are more concerned with increasing subscribership than they are with any partial benefit they might

Indeed, the pass-through limitation will stifle diversity by depriving vertically integrated programmers, such as Rainbow, of the ability to recover their full costs of producing and developing programming, ultimately forcing them to sacrifice quality and innovation in an effort to reduce costs. As a result, contrary to the goal of the 1992 Cable Act, subscribers will suffer from a reduction in programming choices.[37/] The limitation will also place such programmers at a competitive disadvantage with respect to non-integrated programmers, further diminishing diversity and subscriber choice.[38/]

The ramifications of the pass-through limitation extend beyond the relationship between a programmer and an affiliated operator. Forced by the limitation to curtail the wholesale rates charged to affiliates, the vertically-integrated programmer will probably be between cable systems.[39] The combined effect of the pass-through limitation and the anti-discrimination provision, in other words, is to create a cap on the price that an integrated programmer may charge all operators, not just affiliated operators.

The limitation on the pass-through of programming costs attributable to affiliated programming services is also unlawful because it was promulgated without adequate notice.[40] The Administrative Procedure Act requires that an agency give notice of "either

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[39] 47 U.S.C. § 548(c)(2)(B). Apart from the statutory provision, many cable programmers have "most favored nation" contract provisions prohibiting them from charging more to non-affiliated cable operators than they charge to affiliated operators.

[40] See 5 U.S.C. § 553(b).

In addition, the rule suffers serious constitutional infirmities. First, the rule likely would be held to violate the First Amendment. U.S. Const. amend. I. By capping the price an affiliated programmer may charge for its programming, the rule imposes a direct burden on speech and, thus, is subject to heightened scrutiny. See, e.g., Riley v. National Federation of the Blind, 487 U.S. 781, 789 n.5 (1988) (law restricting the fee that could be charged by a professional fundraiser imposed a direct burden on speech, since "a statute regulating how a speaker may speak directly affects that speech"); Leathers v. Medlock, 111 S. Ct. 1438, 1443-44 (1991) (tax imposed on First Amendment speaker triggers heightened scrutiny if it "targets a small group of speakers"). Given the lack of any justifiable rationale the terms or substance of the proposed rule or a description of the subjects and issues involved."[41] Here, the Commission's Notice of Proposed Rulemaking ("Notice")[42] gave neither. The Notice simply asked for comment on whether "certain price changes caused by factors outside the operator's control, *e.g.*, increases in taxes or programming costs, . . . should be permitted to be passed through without prior regulatory review."[43] Nothing in this statement alerts operators to the possibility that limitations could be placed on the pass-throughs permitted vertically integrated operators.[44] In fact, the relationship between cable operators and their affiliated programmers was not a subject or issue of the Notice.

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[40](...continued)
a property interest in their programming. Because these cable programmers will be unable to fully recover their costs for such programming under the Commission's rule, the value of their property will be significantly diminished. These cable programmers will suffer a serious economic impact and their reasonable investment-backed expectations will be frustrated by a rule which fails to advance a legitimate governmental interest, for reasons described above. See, e.g., Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979) (setting forth the elements of a takings claim).

[41] 5 U.S.C. at §553(b)(3).

[42] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Notice of Proposed Rulemaking, 8 FCC Rcd. 510 (1992).

[43] Id. at 529 (emphasis added).

[44] See Home Box Office, 567 F.2d at 36 (agency must "make its views known to the public in a concrete and focused form so as to make criticism or formulation of alternatives possible").

Tellingly, to support the pass-through limit, the Commission relied on the record reviewed and established in an entirely separate proceeding.45/

justified, their capacity and the programs offered over their cable systems."[49] If operators can only raise their rates once annually by just enough to cover inflation (i.e., 60 or 70 cents per month), they will have little or no incentive to add new channels to service tiers or to continue to invest billions of dollars in advanced infrastructure. The public will be deprived of diversity and the deployment of advanced technology will be slowed.

The effort to impose price caps -- initially designed for the telephone industry -- on the cable industry is fundamentally flawed. The telephone and cable industries have significantly different cash flow demands and financial structures. Cable has embarked upon a massive rebuild of its infrastructure, which will cost tens of billions of dollars. Unlike telephony, moreover, cable is not a declining cost industry.[50]

While an inflation-based limitation on future rate increases may have been justified in the case of local exchange carriers and AT&T, it is an ill-fitting Procrustean bed for cable operators. This is particularly true in the context of the 1992 Cable Act, which requires operators to reduce current rates before becoming eligible for the annual inflation-based increase. By contrast, telephone companies were permitted to base price cap adjustments on rates that had been set at artificially high levels (often when inflation and the cost of capital

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[49] 1992 Cable Act, § 2(b)(3).

[50] The Commission's Industry Analysis Division recently found that there currently is a "low level" of pending state telephone rate cases and that, since 1987, the dollar amount of rate reductions and refunds ordered in state rate cases has typically exceeded the dollar amount of increases permitted. Industry Analysis Division, Federal Communications Commission, Trends in Telephone Service, p. 14, March 1993 (rel. April 8, 1993).